IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 175 of 1991

For Approval and Signature:

HON'BLE MR.JUSTICE D.A.MEHTA
and
HON'BLE MS.JUSTICE H.N.DEVANI

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF INCOME TAX

Versus

ADVANCE CONSTRUCTION CO. P. LTD.

Appearance:

1. INCOME TAX REFERENCE No. 175 of 1991

MR MANISH R BHATT for Petitioner No. 1

MR JP SHAH WITH MR MANISH J.SHAH for Respondent No. 1

CORAM : HON'BLE MR.JUSTICE D.A.MEHTA
and
HON'BLE MS.JUSTICE H.N.DEVANI

Date of decision: 25/11/2004

ORAL JUDGEMENT

(Per : HON'BLE MR.JUSTICE D.A.MEHTA)

1 This reference has been preferred by the Commissioner of Income Tax under Section 256(2) of the Income Tax Act,1961 ('the Act') seeking opinion on the following four questions :

"[1] Whether, on the facts and in the circumstances of the case, the Tribunal

is right in law in setting aside the order passed by the CIT u/s.263 of the I.T.Act and thereby restoring the order passed by the ITO ?

[2] Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that the assessee company is an industrial company?

[3] Whether, the Tribunal has not erred in law in allowing the claim of the assessee with regard to the receipt of Rs.11,78,950/- as being provision for contingencies ?

[4] When Rs.11,78,950/- is a receipt by the assessee from the contractors in the course of carrying on of business, whether the Tribunal's order to exclude the same is vitiated in law by irrelevant considerations on the basis of the so called standard accounting matters?"

2 The respondent is a Private Limited Company. The assessment year is 1982-83 and the relevant accounting period is the year ended on 30/6/1981. The respondent assessee declared the total income of Rs.2,52,040/- for the year under consideration. The assessee is a newly incorporated company registered on 31/3/1980 and the accounting year is the first year of its operations. The business of the assessee consists of undertaking contracts in respect of construction of buildings and during the year it was awarded contract of Effluent Channel Project for GIDC as well as CIDCO, Bombay. The assessment was framed on 29/6/1984 at a total income of Rs.2,81,610/- under Section 143(3) of the Act.

3. The Commissioner of Income Tax, Baroda felt that the assessment order was erroneous and prejudicial to the interests of revenue because : (i) the assessee company was treated as "Industrial Company" though it was not engaged in manufacturing activities and, (ii) a sum of Rs.11,78,950/- received by the assessee had not been included in the income chargeable to tax. Accordingly the Commissioner of Income Tax issued show cause notice dated 24/6/1985 under Section 263 of the Act. The assessee furnished its reply on 24/7/1985 enclosing therewith various statements and other documents in

support of its stand that there was no error in the assessment framed by the assessing officer and the proposed action under section 263 of the Act was required to be dropped.

4. The Commissioner of Income Tax did not accept the explanation tendered by the assessee and framed an order on 28/8/1985 u/s.263 of the Act directing the Assessing Officer to modify the assessment order by not applying concessional rate of tax to the assessee company as it was not an "Industrial Company" in light of the observations of Bombay High Court in case of Commissioner of Income Tax (Central), Bombay Vs. Shah Construction Co.Ltd., (1983)142 ITR 696. The Commissioner also directed the Assessing Officer to include the sum of Rs.11,78,950/being the provision for contingencies holding that the same cannot be allowed as deduction during the year of account. This addition was directed to be made in light of the observations of Madras High Court in the case of Commissioner of Income Tax, Tamil Nadu-I Vs. Indian Overseas Bank, 41 CTR 212 = (1985)151 ITR 446.

5 The assessee carried the matter in appeal which was registered as ITA No.1767/AHD/1983. The said appeal came to be disposed of by the Income Tax Appellate Tribunal (the Tribunal) vide its order dated 7/8/1986 whereby the order of Commissioner of Income Tax u/s.263 of the Act was set aside and the appeal was allowed in relation to both the grounds. It is in the aforesaid circumstances that the reference has been brought before us by the revenue.

6 Mr.M.R.Bhatt, learned Senior Standing Counsel appearing on behalf of the applicant-revenue submitted that the Tribunal's finding in relation to the status of the assessee company being "Industrial Company" was erroneous in law in as much as the Tribunal had failed to record any finding regarding the activities carried out by the assessee company. That the Tribunal had merely held in favour of the assessee on the basis that the assessing officer had granted investment allowance of Rs.87,803/- while computing the total income of the assessee and hence, according to the Tribunal, it could safely be concluded for the purpose of revisional jurisdiction that once the assessee was granted investment allowance in respect of the plant and machinery engaged in the same business it cannot be said that the assessee was not engaged in the business of manufacturing activity or processing of goods while deciding upon the status of the assessee company.

According to Mr.Bhatt the controversy was now no longer res integra in light of the Apex Court decision in case of Commissioner of Income Tax Vs.N.C.Budharaja & Co., (1993)204 ITR 412, as well as Bombay High Court decision in case of Shah Construction (supra) relied on by the by the Commissioner of Income Tax. That definition of "Industrial Company" in terms did not permit a Company to be treated as an "Industrial Company" if such company was involved in business of construction other than construction of ships. That the activity of constructing buildings, dams, canals etc., could not be said to be manufacture or production of articles or things as held by the Apex Court in case of Budharaja (supra) and applying the same ratio it could not be stated that the construction activities carried on by the assessee company would amount to manufacture or processing of goods.

6.1. Referring to the finding of the Tribunal, it was submitted by Mr.Bhatt that even if investment allowance was wrongly granted by the revenue, that would not preclude revenue from assailing the order of the Tribunal in relation to the status of the assessee company.

6.2. Mr.Bhatt also invited attention to the following decisions to contend that a company carrying on construction activity cannot be treated as industrial company if it was carrying on construction activity i.e. construction of buildings etc., viz. construction other than ships, and secondly, onus was on the assessee company to show by placing cogent evidence on record that it had income exceeding 51% from such activities as specified in the definition u/s.2(7)(c) of the relevant Finance Act.

[1] (1993)204 ITR 628(SC) - Minocha Bros. Pvt.Ltd. Vs. Commissioner of Income Tax.

[2] (1986)160 ITR 134 (Delhi H.C.) Commissioner of Income Tax, Delhi-I Vs.Minocha Brothers P.Ltd.

[3] (1990)185 ITR 178 (Delhi H.C.) Continental Construction Ltd. Vs. Commissioner of Income Tax.

[4] (1992)198 ITR 649 (Delhi H.C.) Commissioner of Income Tax Vs.Vishal Builders (P) Ltd.

[5] (1989)176 ITR 407 (Bom.H.C.) Commissioner of Income Tax Vs.Oricon Pvt.Ltd.

[6] (1991)188 ITR 537(Bom.H.C.)
Shah Construction Co.Ltd. Vs. Commissioner of Income Tax.
[7] (1997)223 ITR 32 (Gau.)
Commissioner of Income Tax V/s. Highway Construction Co.(P.) Ltd.

[8] (1997)223 ITR 512 (M.P.-Indore Bench).
Badshah Construction Co.(P.) Ltd. Vs.Commissioner of Income Tax.

7 Mr.Bhatt submitted in relation to the second issue regarding taxability of Rs.11,78,950/- that receipt of the said amount was not in dispute and though the same was profit earned out of construction activity same was not shown as income by treating the same as a provision for contingencies. It was submitted by Mr.Bhatt that the Tribunal had taken into consideration irrelevant factors on the basis of so called standard accounting practice without appreciating that Section 4 of the Act provides for charge of income tax and the said charge was in respect of total income of the previous year. That under Chapter IV Part-D 'Profits and Gains of Business or Profession' were to be computed in accordance with provisions of Sections 28 to 43A of the Act. That while computing Profits and Gains of Business or Profession income referred to in Section 28 of the Act had to be computed in accordance with the provisions contained in Sections 30 to 43A of the Act as provided u/s.29 of the Act and if no deduction was provided for in the said group of sections, it was not possible for an assessee to claim any deduction of any sum dehors the said provisions. Mr.Bhatt also relied upon the decision in case of Tuticorin Alkali Chemicals And Fertilizers Ltd. Vs.Commissioner of Income Tax (1997)227 ITR 172(SC) in support of the proposition that accountancy principles and practice cannot determine taxability of an amount if such principles and practice cannot be justified by any provision of the statute or is contrary to it.

7.1 Mr.Bhatt, in support of his stand, invited attention to the statement which is available at page 183 of the Paper Book showing calculation of profit according to Percentage Completion Method to submit that the profit for the year under consideration was actually Rs.15,16,542/and the sum of Rs.11,78,950/- had been deducted therefrom on the basis of so called standard accounting practice. This exercise was not permissible and the revenue was justified in treating the said sum of Rs.11,78,950/- as income chargeable to tax for the year

under consideration. Thus, according to Mr.Bhatt the provisions for anticipated loss, made by the assessee company, was not in consonance with the provisions of the Act and the Tribunal was in error in accepting the stand of the assessee. Mr.Bhatt therefore urged that on both the counts the order of the Tribunal was required to be reversed and order of CIT be restored.

8 Mr.J.P.Shah, learned Advocate appearing on behalf of the respondent assessee company submitted that the findings of the Tribunal were on three grounds : firstly, the Tribunal had held that there was no error in the order of Assessing Officer so as to vest CIT with jurisdiction u/s.263 of the Act; secondly, the assessee company was rightly treated as "Industrial Company"; and thirdly, in light of the accepted standard accounting practice the assessee company had followed a consistent method of accounting. That as the revenue had not challenged the first finding about there being no error in the assessment order, any further discussion on merits of the matter was not warranted.

8.1. In relation to the status of the assessee company it was submitted that the revenue could not be permitted to approbate and reprobate once it had granted investment allowance by holding that the assessee company was involved in manufacture of articles or things for the purpose of Section 32A of the Act, but not for the purpose of Section 2(7)(c) of the Finance Act. That it was an admitted position that the granting of investment allowance had not been disturbed either by the Commissioner while exercising revisional jurisdiction u/s.263 of the Act or by initiating appropriate action under any other provision of the Act. It was further submitted that even on merits, once it was held that the assessee was involved in manufacture or production of articles or things not falling within Eleventh Schedule of the Act, it could not be held against the assessee that for the purpose of being treated as "Industrial Company" it was not manufacturing or processing goods as required u/s.2(7)(c) of the Finance Act.

9 In relation to the second issue regarding taxability of sum of Rs.11,78,950/-, it was submitted that the Tribunal had taken into consideration the accepted standard accounting practice after taking into consideration the commentary by various authors on accountancy and held that the assessee company had adopted and consistently followed a prescribed and recognised method of accounting in case of a contractor involved in civil construction work i.e. Percentage

Completion Method. That the said method was a scientific method and there was no dispute as regards the same. Therefore, according to Mr.Shah there being no error in the order of the Tribunal the reference of the revenue was required to be rejected in relation to both the issues.

10 Mr.M.R.Bhatt submitted in rejoinder that question no.1 would take within its sweep the challenge to the finding of the Tribunal about absence of error in the order of the assessment. In this connection he placed reliance on the decision of Malabar Industrial Co.Ltd. Vs. Commissioner of Income Tax, (2000)243 ITR 83 (SC). He reiterated his submission that merely because investment allowance had been granted and no remedial action had been subsequently taken that by itself should not be sufficient to hold that the assessee should be treated as "Industrial Company".

11 In the case of Malabar Industrial (supra) the Hon'ble Apex Court has held that before the Commissioner can exercise jurisdiction u/s.263 of the Act he has to satisfy two prerequisite conditions viz. (i) assessment order is erroneous and (ii) it is prejudicial to the interests of the revenue. If any one of the conditions does not stand fulfilled recourse cannot be had to Section 263 of the Act. That the provision cannot be invoked to correct each and every type of mistake or error committed by the assessing officer and it is only when an order is erroneous and prejudicial to the interests of revenue that the section will be attracted. While interpreting the phrase "prejudicial to the interests of the revenue" the Court goes on to observe as under :

> " xxx xxx The phrase "prejudicial to the interests of the Revenue" has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the Revenue. For example, when an Income-tax Officer adopted one of the courses permissible in law and it has resulted in loss of Revenue; or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue, unless the view taken by the Income-tax Officer is unsustainable in law xxx xxx".

12 In relation to the first issue regarding status of the assessee company, viz. it should have been treated as an "Industrial Company" or not it is not necessary to record any opinion on merits of the controversy in light of the peculiar facts and circumstances of the case which have come on record. The Tribunal has categorically found that the Assessing Officer has granted investment allowance while computing the total income of the assessee and the said action has not been challenged or disturbed in any manner whatsoever. It is further found by the Tribunal that investment allowance is granted in respect of plant and machinery engaged in the same business. In light of the aforesaid findings of fact recorded by the Tribunal it is deemed proper not to opine on merits of the controversy between the parties and the finding of the Tribunal that once the assessee is granted investment allowance in respect of the plant and machinery utilised in the same business it cannot be said that the assessee was not engaged in the business of manufacturing activity or processing of goods while deciding upon the status of the assessee company is upheld. It is also necessary to record that such investment allowance had been granted in case of the same assessee for the assessment year under consideration and the same remains undisturbed hence, it is not possible, on the peculiar facts of the case, to take a different view of the matter.

13 The assessee was in receipt of total sum of Rs.1,54,82,953/- comprised of certified work as well as uncertified work including reimbursements. As against such receipts, during the accounting period the assessee incurred expenses to the tune of Rs.1,39,66,411/- leaving a difference of Rs.15,16,542/-. The assessee reduced the said figure by sum of Rs.11,78,850/- on the basis of the method of accounting employed by the assessee viz. Percentage Completion Method by working out the said sum as more than one-forth but less than one-half of contract being completed and offered profit of Rs.3,37,592/- as profit of the year. It becomes further clear from the calculation statement available on record that for the next accounting period i.e. year ended 30/6/1982 the assessee similarly reduced a sum of Rs.44,440/- towards more than one-half of contract being completed. The said statement further shows that a sum of Rs.9,43,160/- was written back for the subsequent year and offered for taxation. Similarly a further sum of Rs.2,80,230/- was again written back in the third year i.e. accounting period ended on 30/6/1983. Therefore, it is apparent that a total sum of Rs.12,23,390/- which was reduced in

the year under consideration and the immediately succeeding year was offered for taxation in the immediately succeeding year and the year thereafter. Therefore, on facts it becomes apparent that by the time the contract was completed the total receipts had borne charge of tax and the assessee had derived no advantage as such.

14 However, apart from the aforesaid factual position, it is necessary to note that u/s.145 of the Act income chargeable under the head 'Profits and Gains of Business or Profession' shall be computed in accordance with the method of accounting regularly employed by the assessee. The only exception is : where the method employed is such that in the opinion of the assessing officer income cannot be properly deduced therefrom the assessing officer shall then compute the income upon such basis and in such manner as he may determine. The provision therefore specifically provides that the choice of method of accounting lies with the assessee, the only caveat being that it has to show that the chosen method has been regularly followed. The section is couched in mandatory terms and the department is bound to accept the assessee's choice of method regularly employed, except for the situation, wherein the assessing officer is permitted to intervene, in case it is found that true income, profits and gains cannot be arrived at by the method employed by the assessee. The position of law is further well settled that a regular method adopted by an assessee cannot be rejected merely because it gives benefit to an assessee in certain years.

15. In the present case, the Tribunal has categorically found that "the assessee has followed the standard accounting method as this being the first year of the business it was the sole choice of the assessee to adopt a particular method of accounting contemplated u/s.145 of the Act". It is further admitted by the learned Advocates appearing for the parties that the said method has been constantly followed by the assessee and in subsequent years the revenue has accepted the same.

16 In the case of Badridas Daga Vs. Commissioner of Income-Tax, (1958)34 ITR 10, the Hon'ble Supreme Court has enunciated the following propositions:

> "While section IO(1) of the Indian Income-tax Act,1922, imposes a charge on the profits or gains of a business, it does not provide how these profits are to be computed. Section 10(2) enumerates various items which are admissible as

deductions but they are not exhaustive of all allowances which could be made in ascertaining the profits of a business taxable under section 10(1). Profits and gains which are liable to be taxed under section 10(1) are what are understood to be such under ordinary commercial principles.

When a claim is made for a deduction for which there is no specific provision under section 10(2), whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and be incidental to it. The loss for which a deduction is claimed must be one that springs directly from the carrying on of the business and is incidental to it, and not any loss sustained by the assessee even if it has some connection with his business. If that is established, then the deduction must be allowed, provided that there is no provision against it, express or implied, in the Act."

Sections 28 and 29 of the Act are pari materia with Sections 10(1) & 10(2) of the Indian Income Tax Act,1922. Therefore, the same principles will be applicable to the case at hand. The Tribunal has found that the assessee has followed a method of accounting which is well recognized and is in consonance with standard accounting practice. In these circumstances, on the basis of accepted commercial practice it is not possible to hold that the amount of Rs.11,78,950/- is a receipt which was required to be charged to income tax for the year under consideration in light of the facts which have come on record and the settled legal position.

17 Therefore, the order of the Tribunal does not suffer from any infirmity. The action of the Commissioner u/s. 263 of the Act is bad in law there being no error in the assessment order, much less an error which could be termed as an error prejudicial to the interests of revenue.

18 All the aforesaid four questions referred to us are therefore answered in favour of the assessee and against the revenue. The reference stands disposed of accordingly. There shall be no order as to costs.

(D.A.Mehta, J)

(H.N.Devani,J)

m.m.bhatt